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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term, 1942.

No. 488.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

CHICAGO STOCK YARDS COMPANY.

Brief for the Respondent

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RESPONDENT'S BRIEF.

I.

QUESTIONS PRESENTED.

Did the Circuit Court of Appeals err in deciding:—

1. That, on the facts found by the Board of Tax Appeals, the taxpayer (respondent) was not "a mere holding or investment company" within the meaning of the Act of Congress but was, on the contrary, a top holding company which managed and financed the business of a great integrated enterprise and that therefore the Board, in determining whether the accumulation permitted by the taxpayer was or was not excessive, should use as a measure the needs of the integrated enterprise as a whole as distinguished from using as a measure the non-existent business needs of a mere holding or investment company.

2. That since the main reliance of the Board, in reaching its original conclusion, was its erroneous conception of the measure by which to determine the propriety of the accumulation, it was only fair to remand the case for

reconsideration by the Board and for the final decision by it of the ultimate question, i. e. whether that tribunal is satisfied, on a preponderance of the evidence, that in the decision to distribute no more than $400,000 in each of the tax years the forbidden motive of surtax avoidance played no substantial part.

II.

STATEMENT.

There is no factual dispute between the parties.[1] Such of the facts as are stated in the petitioner's brief find support in the record, although so marshalled as to do less than justice to the position of the Circuit Court of Appeals. Most of them are relevant only to the question whether or not the taxpayer was guilty of a purpose to evade—which is the ultimate question sent back for future determination by the Board of Tax Appeals. Wherever in the course of respondent's argument facts additional to those stated by the petitioner are relied upon, appropriate references to the record will be inserted.

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[1] On page 6 of the Commissioner's petition for the writ, the government itself says "The taxpayer is the top holding company of . . . a great integrated business owning or operating a stockyard, a belt line railway, an elevated street railway, a real estate development of considerable magnitude, power and light facilities, a national bank serving the stockyard area, and other related undertakings of lesser importance"; and annexes the chart adopted by the Court below, and a copy of which is attached at the end of this brief.

III.
ARGUMENT.

1. Summary of Argument.

The size of the record, the number of exhibits and the length of the petitioner's able brief give the impression that this Court is now being asked to consider complicated and disputable matters of fact. This, the taxpayer suggests, is a misapprehension.

In final analysis the problem now presented for solution is merely whether the Court below erred in remanding the case to the Board of Tax Appeals for the determination by it of an ultimate question of fact; the determination to be made by the Board in the light of a correction made by the Circuit Court of Appeals of what the Court regarded as an erroneous conception entertained by the Board of the meaning of Section 104 of the Revenue Act of 1928 as applied to the undisputed facts in this case.*

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* "SEC. 104. ACCUMULATION OF SURPLUS TO EVADE SURTAXES.

"(a) If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 50 per centum of the amount thereof, which shall be in addition to the tax imposed by section 13 and shall be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax.

"(b) The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax."

If the judgment of the Court below is affirmed it will be because this Court approves the interpretation of the Act of Congress as made by the Circuit Court of Appeals. In that event it will become the duty of the Board of Tax Appeals to give a final answer to the ultimate question of fact, i. e., "Did the taxpayer accumulate gains and profits during the three tax years and if so did the forbidden motive of tax avoidance play a substantial part in determining the taxpayer's motive for making the accumulation?"

On the original hearing this question was answered by the Board adversely to the respondent. The Board gave this answer after first deciding that the statutory term "mere holding or investment company" was intended by Congress to apply to such a corporation as the record discloses the taxpayer to be. Having thus classified the taxpayer, the way was open for the Board to find that a mere holding or investment company has no legitimate business need for any accumulation whatever; that the accumulation in fact made by the taxpayer was therefore unreasonable; and that there was no assignable reason for it except the motive to evade surtaxes.

By thus classifying the taxpayer, the Board gained the support of the two statutory presumptions which Congress has provided to facilitate proof of the interdicted purpose—one, the presumption arising from the absence of any corporate activity except investment; and the other from the existence of an accumulation unreasonably large with relation to the needs of "the business."

The Circuit Court of Appeals on the other hand conceived that Congress, when it used the words "mere holding or investment company," did not mean that a corporation like the taxpayer is to be treated as if it existed in a

vacuum, but rather in the economic setting disclosed by the facts found by the Board—as an essential part of a great integrated industrial enterprise; and that when so viewed its business and business needs must be considered in the light of the position it occupies in the enterprise. Its holdings in subsidiaries which are parts of the enterprise are more than just "investments"; "loans" made for the purpose of protecting different units of the enterprise are different from distributions to Mr. Prince in the guise of loans; and the business needs of the taxpayer are co-extensive with the business needs of the enterprise. It is then no longer possible to view the taxpayer as a "mere holding or investment company." It is not like the Massachusetts Investors Trust, but, like the American Telephone & Telegraph Company, is a directing force and financial department of a large integrated industrial enterprise which may have needs justifying accumulations of earnings by the department which functions as the treasury of the enterprise.

While the Board (as an alternative ground of decision) purported to decide the case without the aid of the statutory presumptions it made no specific findings of fact as to the actual existence of the condemned purpose from which, independently of them, its conclusions could be drawn; and the Circuit Court of Appeals was of opinion that these presumptions, found to exist by an erroneous conception of the law, had so preoccupied and influenced the Board as to entitle the taxpayer, in the interest of fairness and justice, to a new trial freed from such error.

The taxpayer now submits two contentions for the consideration of this Court:—

1. That the Circuit Court of Appeals was right in reversing the Board on its interpretation of the Act and

in deciding that upon the undisputed facts (stated and discussed in the brief) the taxpayer is not a mere holding or investment company having no business need for any accumulation, and that the proper measure of the controverted accumulation is the aggregate business need of the entire integrated enterprise which the taxpayer financed and managed.

2. That on the ultimate question of fact (i. e., the existence or non-existence of the forbidden purpose) the Circuit Court of Appeals by no means substituted its judgment for that of the Board but properly exercised the familiar judicial discretion to order a new trial by the trier of facts, unembarrassed by the errors which had prevented the first trial from being fair to the taxpayer.

If this Court approves the decision of the Court below respecting the nature and function of the taxpayer the only question for present decision is a procedural question, i. e., whether a new trial before the Board shall be permitted to proceed as ordered or whether this Court will overrule the discretion of the Court below in holding that the needs of justice require such a new trial to be had.

The taxpayer respectfully submits the argument which follows in support of the contention that the Court below committed no error and that its judgment on all points should be affirmed. In the course of the argument the respondent will answer the petitioner's contention that the classification of the respondent as a mere holding or investment company is an unreviewable determination of a matter of fact.*

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*See Infra, page 20.

The answer will be to the effect that the judicial power of the United States is properly exercised when this Court supplies an administrative tribunal with an authoritative interpretation of a statutory formula. When the formula has thus been authoritatively interpreted, the administrative tribunal is thereafter left free to apply it to the varying fact situations which present themselves. The instant case is the first in which this Court has been called upon authoritatively to declare the meaning of the statutory phrase "a mere holding or investment company."

2. The Facts Emphasized by Respondent.

The three tax years are 1930, 1932 and 1933. Long before these years and during all three of them the taxpayer was entitled by contract to receive and did receive substantially all the earnings of the operating subsidiaries in the Stock Yards enterprise. The stock of one important and of two unimportant subsidiaries was directly owned by the taxpayer (3 R 902-913). The stock of the other subsidiaries was owned by the Jersey Company which was itself controlled by the taxpayer through stock ownership. The income of the taxpayer was derived almost entirely from earnings of the subsidiaries which found their way into the taxpayer's treasury. The taxpayer, beginning in 1911, planned to accumulate these earnings (after paying reasonable dividends which for many years prior to 1930 had been at the rate of 5%) to the extent necessary to liquidate the Jersey Co. and pay off its securities held by the public when its charter should expire in 1940 and in the meantime to meet the financial requirements of the several subsidiaries which otherwise would have been helpless as a result of the liberal dividend policy imposed upon them in the exercise of the taxpayer's ultimate power of control

(3 R 926-7; 930; 942-3). By the By-Pass agreement made October 1, 1914,[1] between the taxpayer and the Jersey Co. the earnings of these subsidiaries, after paying a dividend of 6% on Jersey preferred shares and 9% on Jersey common shares owned by the public, flowed automatically and directly into the treasury of the taxpayer (3 R 908). By thus absorbing all the net earnings of its subsidiaries the taxpayer necessarily subjected itself to an obligation to protect all of their securities outstanding in the hands of the public.[2]

Thus the taxpayer, having absorbed the earnings of the subsidiaries, properly accepted the resulting responsibility to supply their financial needs, including provision for the ultimate payment of all their obligations.

The Circuit Court of Appeals decided that the expression "mere holding or investment company" as used in the Act of Congress, was never intended to apply to a company with activities such as these and held that the taxpayer was far more than a "mere holding or investment company." In a later part of this brief [3] we present our reasons for thinking that the Circuit Court of Appeals was right. At this stage of the argument we merely assume the soundness of the decision and proceed to a statement of the facts which, on that assumption, are of controlling significance.

A. Over-all View of the Three Tax Years.

Consider first, if the Court please, the situation at the beginning of the first of the three tax years.

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[1] This so-called "By-Pass Agreement" (Ex. S-46) is scarcely mentioned by the petitioner but is regarded by the taxpayer as having the significance above attributed to it, and is printed at the end of this brief.

[2] See infra pages 31-33.

[3] See infra pages 19-20.

By January 1, 1930 the taxpayer had accumulated in its treasury liquid assets of about $12,000,000. Obligations of the Enterprise which, if the plan of liquidation were carried out, had to be paid off by 1940, amounted to over $30,000,000. The other units of the enterprise had a total of liquid assets scattered among them of about $9,600,000 of which over $2,000,000 were impounded in court pending the decision of a case. The enterprise needed a minimum liquid working capital of $5,000,000.

Consider, next, the situation at the close of the three-year period.

At the end of 1933, the net liquid position of the enterprise as a whole was $1,000,000 less favorable than on January 1, 1930; obligations had declined by about $3,000,000, but liquid assets had declined about $4,000,000. This was chiefly due to the necessity for using funds to save the Stock Yards' Banks in 1932 and 1933.[1] But the liquid assets of the enterprise were less equally divided between the taxpayer and the other units. The liquid assets of the taxpayer *increased* by about $2,000,000 to about $14,000,000; while those of the rest of the enterprise *decreased* by about $5,800,000 to about $3,800,000 (Resp Ex C pages headed 1929-1933).

This was in line with the policy which the taxpayer had followed for years of having the subsidiaries make dividend distributions in excess of their earnings in order to build up the treasury of the taxpayer as originally planned. Thus in 1933 when the enterprise as a whole had earnings of only $185,000, the taxpayer withdrew over $2,000,000 from the other units as dividends.

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[1] See infra, p. 17.

If surtax evasion had been in the mind of the taxpayer, none of the subsidiaries would have declared any dividends during this period and the income of the taxpayer would have been immensely reduced. In at least one year—1933—the taxpayer's income would have been less than the dividends which it actually paid. For years the taxpayer, as the treasury department of the enterprise and in accordance with the plan, filled its own treasury from the Jersey Company and the subsidiaries, withdrawing all their current earnings and more. How simple it would have been to escape surtax, if that were in the mind of the taxpayer, by allowing funds to accumulate in the treasury of the Jersey Company so that that company, rather than the taxpayer, would be in a position to meet the Jersey obligations.

As a matter of fact, during this period of four years, after paying the dividends which it paid and after sinking the funds which it did in saving the banks, the enterprise accumulated no funds available for further distribution as dividends. During this period the enterprise earned $12,170,933.72 (3 R 921) out of which it paid as dividends to public shareholders of the Jersey Co. stock $1,734,000 (3 R 922) and as dividends to holders of stock of the Maine Co. $1,600,000 (3 R 918)—a total distribution in dividends of $3,334,000. This left income available for distribution of $8,836,933.72; but during this period $12,833,633.61 (3 R 912, 914-5) was poured into the Stock Yards banks in the form of cash and either promptly lost or frozen.

Following this "over-all view" of the tax period the Court is asked to consider the three years one by one.

B. The Tax Year 1930.

The course of corporate conduct consistently followed by taxpayer had resulted in the following financial situation when 1930 began (3 R 914. Resp Ex C page headed 1929):—

The aggregate bonded indebtedness of the taxpayer and of all subsidiaries was	$23,963,000.00
The aggregate of available liquid assets was	$16,705,185.06*
Leaving an excess of bonded debt over available liquid assets of	$ 7,257,814.94

Included in these liquid assets were the securities in the portfolio of taxpayer purchased out of the earnings of the subsidiaries and held for the ultimate liquidation of the Jersey Company and (in the interval) for meeting the needs of the subsidiaries. These securities were, to the extent of over 94%, the shares of corporations within the limits of the integrated enterprise which the taxpayer was managing and financing (3 R 919, 939). The income of the taxpayer from investments for 1929 amounted to $2,651,739.24 (3 R 940). Of this amount $27,742.75, or only 1.047% came from outside investments (3 R 939-40). The accumulation in the taxpayer's treasury on December 31, 1929 was about $12,000,000.00 (3 R 914).

If (as is so uniformly contended by the Commissioner in tax cases involving a series of years) each year is considered by itself, it will be for the Board to decide, under

* After reserving $5,000,000 for working capital (1 R 298; 2 R 852).

the instructions of the Circuit Court of Appeals, whether the interdicted purpose substantially influenced in 1930 the course which was in fact followed.

The specific business problem which confronted the taxpayer in 1930 was the extent of the profit distribution which the Chicago Enterprise as a whole might safely make in that year through the medium of a dividend declaration by the taxpayer.

It was, we submit, no time to take chances. In the previous October the financial crisis had been precipitated. Four of the leading banking houses of Boston had failed. There was a panic there as well as on the New York Stock Exchange. The problem before practically every bank and business corporation was not how to reduce taxes but how to avoid utter collapse. No prudent board of directors in any corporatoin of any sort would have chosen 1930 as the year in which to *increase* the customary dividend.

Assume that on December 31, 1930 the Board of Directors of the taxpayer, after having declared and paid a 5% dividend, had met to consider an extra dividend. Assume also that they then left out of consideration any further accumulation to retire the shares (preferred or common) of the Jersey Company and merely figured on the relation of presently available liquid assets of the entire enterprise to the bonded indebtedness thereof. In other words, assume that they abandoned the original Prince-Armour plan of ultimately acquiring sole ownership for themselves and that they looked forward to liquidation in 1940 for the benefit of whomever might then be the shareholders of the Jersey Company. On these assumptions the figures confronting them (after reserving $5,000,000 as necessary working capital) were these (Resp Ex C page headed 1930):—

Bonded Indebtedness	$22,379,000.00
Available Liquid Assets	17,933,683.98*
Leaving an excess of bonded debt over available liquid assets of	$ 4,445,316.02

During the year, pursuant to the original Prince-Armour plan, they had accomplished a reduction of bonded indebtedness of approximately a million and a half dollars and they had bought for the taxpayer some 190 shares of Jersey preferred and 253 shares of Jersey common (3 R 927). This left them with net earnings in excess of a million dollars, which, while in itself an immense sum, was small in relation to the contingent needs of the business as a whole. The directors decided not to distribute this or any part of it by way of extra dividend. If they could actually have foreseen what was to happen in the later tax years, this decision would have been reached without a moment's debate. But even as it was, with the country's financial situation in 1929 and 1930 immediately behind them, we earnestly submit that sound business policy required them to decide as they did.

This contention, the Court will observe, is based upon the assumption (made for the sake of the argument) that the original plan of accumulation was so far modified as to drop out of consideration the buying up of all outstanding Jersey stock. It is based further (likewise for the sake of the argument) on acceptance of the view of the Government experts that such acquisitions, if they were thereafter to be made, might be made with borrowed money; or, if not made by the taxpayer, might or might not be made

* Includes impounded charges of $2,013,523.24 which were not released to the Transit Co. until 1932 (3 R 914).

by Prince out of his separate estate. The contention is merely this: that on December 31, 1930, looking at the enterprise as a whole and with a deficiency of liquid assets of $4,000,000 below bonded indebtedness, the taxpayer should have an opportunity to urge upon the Board that no inference of tax evasion should be drawn from the decision not to declare an extra dividend.

If this be so, without reference to outstanding Jersey preferred, let the picture be changed by taking that factor into consideration. The preferred was entitled to preference in liquidation and must be taken care of just as much as bonded debt. Of these preferred shares 64,353 were outstanding at the end of 1930 (Resp Ex C page headed 1930). Their liquidation value at par was $6,435,300.00. So that (still without reference to any further acquisition of common) the excess over liquid assets of what, for purposes of liquidation, were obligations ahead of common was more than ten million dollars.

We respectfully submit that it is only fair to allow the Board to consider whether, in such a picture, the shadow of an illicit purpose is discernible.

C. The Tax Year 1932.

We next ask the attention of the Court to the second of the three tax years.

Let it be supposed that the directors of the taxpayer had met on the last day of that year (1932) to consider whether or not the financial situation of the enterprise justified an extra dividend. The regular dividend of $400,000 had been declared during the course of the year (3 R 918).

The figures respecting the entire enterprise submitted by the treasurer would have shown the following (Resp Ex C page headed 1932):—

Bonded Debt	$21,434,000.00
Available Liquid Assets	14,849,691.09*
Leaving an excess of bonded debt over available liquid assets of	$ 6,584,308.91

During the year the bonded debt had been reduced by $672,500.00. Pursuant to the original plan, 302 shares of Jersey preferred had been bought and 380 shares of Jersey common (3 R 928). The taxpayer had sucked up into its treasury income from other units of $2,196,614.10 (Ex S51; 3 R 921); but it had poured or caused other units to pour cash as follows into banks to prevent failures which would have meant disaster to the Stock Yards' enterprise (3 R 914-915):—

The Maine Company (respondent)	$3,071,779.18
The Central Mfg. District	501,439.58
The Transit Company	1,340,000.00
The Produce Terminal	350,000.00
Making a total for the year of	$5,263,218.76

The problem of the directors, therefore, was whether to ignore the situation of the enterprise as a whole or to think realistically and so conserve the net income on the books of the taxpayer to help bridge the gap between a bonded debt of twenty-one millions and available liquid assets of only two-thirds of that sum—a gap which had grown wider during the preceding twelve-month.

*After reserving $500,000 for working capital.

In thus stating their problem we are again (as in 1930—and merely for the purposes of the argument) leaving out of the picture further accumulation for the retirement of stock. Even on this assumption we submit that it would have been sheer folly to declare an extra dividend on taxpayer's stock when the earnings of the enterprise as a whole had been assembled in the interest of its own self-preservation and when every dollar of net income seemed likely to be needed before the financial storm had passed.

If, as before, we bring the then outstanding Jersey preferred into the picture the soundness of the directors' decision becomes even clearer. There were 63,435 shares of preferred then outstanding which, like the bonded debts, were essential elements in the liquidation problem. (Resp Ex C page headed 1932.) If their par value be included in determining the excess of "liquidation liabilities" over available assets the excess of liabilities would be $12,927,808.91. With liquidation only eight years away and an unpredictable financial condition in the interval, we submit that it should be left to the Board to determine whether the business reason for declaring no extra dividend was not so compelling as to deprive the suggestion of tax-evasion of all weight.

D. The Tax Year 1933.

Had the directors of the taxpayer met on December 31, 1933, nobody fit to be a director would even have considered an extra dividend.

The bonded debt as of that date was..	$21,197,000.00
The available liquid assets were.....	12,829,969.74*
Leaving a deficiency for liquidation purposes of	8,367,030.26

(Resp Ex C page headed 1933.)

*After reserving $500,000 for working capital.

During the year the bonded debt had been reduced by $237,000.00, and 797 shares of Jersey preferred and 357 shares of Jersey common had been bought (3 R 928). The item of net income on the taxpayer's books *appeared* to be large ($2,243,840.98) (3 R 921); but in order to make this showing the taxpayer had sucked up from the Transit Company $1,716,000.00, which Company in that year had suffered an actual loss of $827,463.49 (3 R 922), and from the Produce Terminal Company $200,000.00, although its net income for the year was only $29,850.39 (3 R 923). The operating loss of the Transit Company was due to the fact that under the management of the taxpayer it had poured into banks to avert failure and had lost no less than $1,016,414.84 (3 R 915). Looking at a consolidated balance sheet of the whole enterprise the directors would have found a net income of only $185,996 (3 R 921).

But even this was not the whole story. To save Stock Yards' banks from failing and in a successful attempt to stop "runs", the following deposits in such banks had been voluntarily subordinated to the claims of other depositors (3 R 914-915):—

The Taxpayer	$1,800,000.00
The Transit Co.	1,300,000.00
The Produce Terminal	300,000.00
The District	600,000.00
Making an aggregate of	$4,000,000.00

For a similar purpose a subscription to the capital stock of a new Stock Yards Bank had been made during the year by the taxpayer in the sum of $1,500,000.00 (3 R 912). By the end of 1933, therefore, the directors would have been

faced by a tie-up of funds of nearly thirteen million dollars as the result of a successful effort to prevent bank disasters, a portion of which total had by that time already become a loss. There were then outstanding Jersey preferred shares of the par value of $6,236,880.00 (Resp Ex C page headed 1933). With these "liquidation liabilities" included in the picture there was an excess of such liabilities over available liquid assets of $14,603,910.26. The Court will have it in mind that in addition to the dividend of $400,000 (3 R 918) declared by the directors of taxpayer during 1933 there had also been distributed by the Jersey Company from its net income $425,412 (3 R 922) by way of dividend on such securities as were held by the public. This means that during the year in question there had actually been distributed by the taxpayer and by the Jersey Company $825,412. We press the suggestion that with aggregate net earnings of $185,996 (3 R 921) for the whole enterprise and a deficiency of assets for liquidation purposes of more than $14,000,000 the declaration on December 31, 1933 of a dividend additional to the $825,000 already distributed would have been the act of financial gamblers.

We accordingly submit that the taxpayer is fairly entitled to have its case further considered by the Board. The Board, upon such reconsideration, will be in a position to determine whether on such a record there should be imputed to the taxpayer a motive of tax evasion or whether the existence of such a motive is affirmatively disproved by the act of the taxpayer in thus sucking up funds from subsidiaries. The Board will consider whether, if there had been any thought of tax evasion, the funds of subsidiaries would not have been allowed to remain in their several treasuries so that the taxpayer would have

had no net income in excess of its usual dividend requirements. The Board may conclude that what on the first trial it subconsciously did was to read back into the tax years the later Personal Holding Company statutes which ignore motive and make the mere *fact* of accumulation decisive. Had these acts been in force during the tax years and if the taxpayer had desired to reduce surtaxes, it would not have followed the plan actually followed of assembling all funds in a central treasury against the arrival of the liquidation date.

It is respectfully submitted that a review of the three tax years considered together and of each considered separately leads to the conclusion that the Court below was doing no more than justice when it remanded the case for reconsideration by the Board unembarrassed by what the Circuit Court of Appeals regarded as the erroneous conception of the taxpayer's place in the Stock Yards' Enterprise.

3. Propositions Relied Upon by Respondent.

(1) Taxpayer Is Not a "Mere Holding or Investment Co."

Up to this point it has been assumed in this brief that the Court below was right in holding that the taxpayer was much more than a mere holding or investment company within the meaning of the Revenue Act.

The importance of the point is obviously great; because if the taxpayer were such a company as the Board held it to be, it would have had no need for any accumulation whatever. As there was in fact a large accumulation at the beginning of the tax period and as, during that period,

only a part of its income was distributed, there was (on the Board's theory) no business need which the taxpayer could advance to overcome the statutory inference of a forbidden purpose. There being no good reason for *any* accumulation, the existence of *some* accumulation was, the Board argued, persuasive evidence of a purpose to evade. On the other hand, if the case were to be submitted to the Board free from the erroneous ruling that the taxpayer was a mere holding or investment company having no business needs, it would be the function of the Board to recognize the propriety of *some* accumulation and then to determine whether the accumulation in fact made during the tax years was to a substantial degree motivated by a purpose to reduce surtaxes.

(a) The Judicial Power of the United States may properly be exercised in reviewing the interpretation placed by the Board of Tax Appeals upon statutory language.

At this point we meet and answer the petitioner's contention that the decision of the Board on the meaning of the Act of Congress is not subject to judicial review. The taxpayer now urges upon the Court an entirely different conception of the judicial function.

We submit that any abstract discussion of the difference between fact and law is here unnecessary in view of the wise policy of this Court always to make an authoritative statement of the meaning of a statutory phrase for the guidance of administrative tribunals in reaching their subsequent determinations. There has hitherto been no such statement by this Court of the meaning of the phrase "mere holding or investment company," although the need for clarification is obvious when the Board says it means one thing and the Circuit Court of Appeals says it means an-

other. Surely both the Government and the taxpayer are entitled to an exercise of the judicial power of the United States for the determination of an issue respecting the true intent and meaning of a statute.

If the Court approves this approach to the problem it will be following the course of its decisions in the case of analogous statutory declarations.

Thus in determining the meaning of "a gift in contemplation of death" this Court did not hesitate to review (at the instance of the Government) a finding of the Court of Claims on that point. While the appeal was disposed of on other grounds, this Court made it clear that the finding was by no means unreviewable and made its authoritative declaration accordingly. *U. S. v. Wells*, 283 U. S. 102 (1931). This declaration thus became the norm for the determination of other cases, as appears from *Colorado National Bank v. Commissioner*, 305 U. S. 23 (1938) in which case the Board of Tax Appeals had held that the transfer "was not made in contemplation of death within the meaning of the statute as explained in *U. S. v. Wells.*"

The same course has been followed in other instances; in *Deputy v. duPont*, 308 U. S. 488 (1940) and *Magruder v. Realty Corp.*, 316 U. S. 69 (1942) respecting the meaning of "ordinary and necessary expenses" and "carrying on or doing business"; in *Helvering v. Price*, 309 U. S. 409 (1940) respecting a provision of the Revenue Act governing deduction of losses; and in *U. S. v. Carolina Carriers Corp.*, 315 U. S. 475, 489 (1942) respecting the interpretation of statutory standards by the Interstate Commerce Commission. Another case in which an authoritative interpretation will be needed is the statutory use of the word "beneficiaries" in Sec. 503 (a) (1) of the Code which was

considered by the Board of Tax Appeals (now the Tax Court) in *Steuben Securities Corporation v. Commonwealth*, decided January 5, 1943. The course now advocated was also followed by this Court in *S. E. C. v. Chenery Corp.* (decided February 1, 1943) respecting the meaning of the phrases "fair and equitable" and "detrimental to the interests of investors." In the case last cited this Court observed (page 11 of slip opinion):

> "if the action is based upon a determination of law as to which the reviewing authority of the courts does come into play, an order may not stand if the agency has misconceived the law . . . We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained."

(b) The facts which give rise to the problem of interpretation.

A very brief restatement of significant facts will enable the Court to appreciate the strength of the position taken by the Court below on this phase of the case.

By 1911, when the taxpayer was organized, the Chicago Stock Yards was a great industrial enterprise, owning or operating a stock yard, belt line railway, real estate developments, elevated street railway, power and light facilities, etc. This enterprise had started in 1865 as one corporation, but for economic and legal reasons, had been split into several organizations and corporations, all of which were tied together by the Jersey Company, which was a parent corporation, holding the stock of the subsidiaries and financing, operating and managing them (3 R 902-906). Corporate organizations were multiplied but the business remained unitary.

The success of the enterprise was dependent upon the continued location of the slaughter houses of the packers in the vicinity of the yards. In 1890, the packers threatened to move away, with consequent ruin to the enterprise, unless they received a substantial payment for staying. F. H. Prince and associates of his formed the Jersey Company to raise funds to make this payment, which the Transit Company (the only operating company) was unable to do itself. He was successful, and contracts were entered into by the packers in which they promised to keep their slaughter houses in the vicinity of the yards until 1906 as to some and 1907 as to others (3 R 902-3). When these contracts expired, the packers renewed their threats (3 R 906).

(c) The taxpayer and the plan it was formed to execute.

After long negotiations had taken place, Mr. Prince evolved a simple and brilliant plan to eliminate this threat and thus to safeguard interests of the stockholders of the Jersey Company and, at the same time, if the plan worked out, to make a profit for himself. He reasoned that if at least one of the principal packers had a permanent interest in the enterprise, the packer threat would no longer exist. He sold his idea to Armour, one of the packers. (3 R 906.)

At that time the Jersey Company was substantially in debt. It had issued $14,000,000 of bonds, secured by all of the stock of the Railway Company, substantially all of the stock of the Transit Company (from which two corporations it derived nearly all of its income) and $2,500,000 of securities the Jersey Company owned. (1 R 46-47; 52-53; Ex S24.) The Jersey Company had outstanding $6,500,000 6% preferred stock and $6,500,000 common stock (3 R 903). Each share of each class had a par of $100 and was entitled to vote (3 R 903).

The plan was as follows:—

Prince and Armour formed a new corporation—the taxpayer—with a cash capital of $1,000,000. Prince owned 80.6% of the stock and Armour 19.4%. The corporation offered to Jersey Company common stockholders in the alternative (a) $200 principal amount of its own 5% bonds for each share of Jersey common and secured by the common for which the bonds were exchanged or (b) a guaranty by the new company of 9% dividends a year per Jersey common share in consideration of the assignment by the Jersey stockholders of all dividends in excess of 9%; so that each Jersey common stockholder would, if the plan worked out (and the taxpayer risked its entire resources on that eventuality) receive the capital invested plus a return of either 9% or 10%. (3 R 906-908.)

The Jersey Company's charter expired by law on July 10, 1940; and one of the features of the plan was that the Jersey Company, whose bonds and preferred stock were non-callable, should be liquidated when its life came to an end, its obligations discharged, and its preferred stock paid off. Another feature was that the common stock of the Jersey Company, which would become the owner of the Chicago end of the enterprise upon the payment of these senior securities, should be acquired as fast as possible for bonds of the taxpayer or for cash. Sufficient bonds of the taxpayer—$13,000,000—were authorized so that all of the Jersey common—$6,500,000—could be acquired for bonds. This plan required, and Prince and Armour decided, that the money which would eventually be needed to execute it, should be taken out of the earnings of the enterprise; and for this purpose the treasury of the taxpayer was to be the treasury of the enterprise as a whole (3 R 908, 927; 1 R 355-358).

All of the Jersey common shareholders in due course (except three whose shares were acquired by the taxpayer in 1919 for cash) accepted one or other of the alternatives. (3 R 908.) By December 31, 1912, the taxpayer had actually invested $6,174,200 in the execution of the plan. (Ex S59 and S61.) The plan was thus adopted and the taxpayer committed to its execution before there were any income tax laws to evade or even any constitutional amendment making such a law possible.

(d) The execution of the plan.

The plan was carried out continuously in accordance with its original conception. The taxpayer acquired common stock of the Jersey Company as fast as it could and accumulated earnings to provide for the liquidation of that company.

In 1914, the Jersey Company became just a shell which had to be kept alive on account of its outstanding securities and guarantees which then, outside of its common stock, amounted to over $25,411.00 (Ex S-46). In that year the "By-Pass" agreement was entered into between the taxpayer and the Jersey Company whereby the net income of the Jersey Company (after 6% preferred and 9% common guaranteed dividends) by-passed that company and went direct to the taxpayer. By that agreement the Jersey Company foreclosed itself from ever accumulating any funds (except with the consent of the taxpayer) with which to meet the principal payments which would come due upon securities which it had issued or guaranteed. The taxpayer in accordance with the plan, undertook to provide for such payments by accumulating a portion of the funds it received under that agreement.

By this time the taxpayer had stepped into the Jersey Company's shoes as the head of the Enterprise. During the period in issue in this case, and for many years prior, Mr. Prince was the sole or dominant stockholder of the taxpayer, its president with a salary of $50,000 a year, and a paid officer, with a smaller salary of the Jersey Company, and two of the Chicago units of the Enterprise. During the period in issue the testimony on this point (which was offered by the taxpayer and was not contradicted) was that the taxpayer through Mr. Prince, its president, and to a lesser extent through Mr. McDonough, its vice-president, supervised, directed and managed the affairs of the subsidiaries other than routine business. (1 R 142-151; 187-8; 190-3; 225-7; 243-7; 287-291; 294.)

From time to time the taxpayer was required by business necessity of the Enterprise to use funds for various purposes. In 1922, it loaned Mr. Prince $2,300,000 to enable him to buy out the Armour interest in the taxpayer when a United States Court decreed that packer and stockyards' interests must be divorced and the taxpayer could not directly buy from Armour. (3 R 909.) In 1932 and 1933, it became necessary to save banks in Chicago from failure. This required the expenditure of over $12,833,633.61 (3 R 912, 914) which was made by the taxpayer and other units of the enterprise under its direction (3 R 912, 914-5). In 1932, it became necessary for the taxpayer to lend $1,000,000 to Mr. Prince to enable him to secure sufficient control of Armour & Co. so that its business might be retained for the stockyards (3 R 926).

In short, the taxpayer thus became and remained the dominant company of the corporate structure. Substantially all of the profits of the subsidiary companies not used

to pay interest and dividends on their publicly-held securities ultimately found their way into the treasury of the taxpayer; and it was the taxpayer that directed all corporate policies, met any deficits in the subsidiary treasuries, and provided the funds when any unusual expenditures were required. At the beginning of its existence and before the Sixteenth Amendment was adopted, the taxpayer established a long-range policy of accumulating funds against the day in 1940 when the charter of the Jersey Company should expire and sums aggregating over $30,000,000 would be needed for its liquidation. Beginning in 1924 and throughout 1933, the taxpayer paid dividends of $400,000 per annum (which was 40% on the original investment), the balance of its earnings being accumulated in its treasury for the purpose above set forth.* (3 R 918.)

Those are the objective facts found by the Board and accepted in full by the Court below. This statement is qualified only to the extent that the Board in its opinion (3 R 938) attributed to Prince as an individual the exercise of the powers[1] of management which we, and the witnesses who testified, ascribe to the taxpayer. Upon them the Board concluded that the taxpayer was a mere holding or investment company and the Court below held that the conclusion was erroneous as a matter of law.

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*No question as to the propriety of this plan was pressed under Section 104 of the Revenue Act of 1928 (or under the like sections in the Act of 1913 and subsequent revenue acts) until sometime in 1936 when, for the first time, the Commissioner asserted that the continuing accumulations of surplus under the plan adopted in 1911 had subjected the taxpayer to the penalty tax provided by Section 104 (a) of the statutes enacted in 1928 and 1932.

[1] The petitioner, in its statement (Petitioner's brief, p. 20), treated the Board's statement in its opinion as the facts rather than the facts found by the Board in its Findings of Fact Nos. 35 and 36 (3 R 929-30).

At this point we suggest the utter unsoundness of petitioner's contention and the Board's holding that the actual management and financing of the several subsidiaries in the Stock Yards enterprise is, as matter of law, to be attributed to Prince as an individual—thus bolstering the proposition that the taxpayer invested but did not manage. But under the plan of liquidation and the By-Pass Agreement of October 1, 1914, it became and was the bounden duty of the taxpayer to finance the subsidiaries whose earnings it absorbed. The situation was not different in substance from what it would have been if the entire enterprise had been owned by one corporation, which had several branches or departments, with each department having its own set of creditors and obligations which the enterprise as a whole must take care of. Since such financing actually took place, the petitioner is in substance contending that the things thus done are to be attributed not to the taxpayer under duty to do them but to a third person acting for the honor of the taxpayer. If this contention were to prevail, the taxpayer would be encouraged to contend that it was Prince as an individual who made the accumulation here complained of and that the attempt to penalize the incorporated taxpayer for permitting itself to be availed of for an unlawful purpose must therefore fail. In either case such a contention should be stigmatized as a fairly desperate effort to blink the realities of the situation. The taxpayer in fact did the financing and if there was any illegal accumulation must take the consequences. The management and financing of the subsidiaries was the necessary and proper result of their control by the taxpayer. Prince owned none of the stock of the subsidiaries and served in official capacities at stated salaries merely as the result of the control lodged

with the taxpayer. The taxpayer ventures to suggest that the argument of the petitioner on the merits gains nothing from the invocation of such highly artificial reasoning.

We have already cited authorities to the effect that, upon the facts found by the Board, the question whether the taxpayer was a "mere holding or investment company" within the meaning of the Act is open for determination by this Court (supra pp. 21-22).

(c) The Applicable Treasury Regulation.

The conclusion of the Court below is supported not only by the decisions but even by the provisions of Article 542 of Treasury Regulations 74 (promulgated under the Revenue Act of 1928) which reads in part as follows:

> "* * * When one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance the business of the first corporation. Gains and profits of the first corporation put into the second through the purchase of stock or otherwise may therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. To establish that the business of one corporation can be regarded as including the business of another it is ordinarily essential that the first corporation own substantially all of the stock of the second. Investment by a corporation of its income in stock and securities of another corporation is not without anything further to be regarded as employment of the income in its business."

The provisions of Regulation 77 promulgated under the Revenue Act of 1932 are substantially identical. In fact, substantially the same regulation was in existence at the

time of the passage of the Revenue Acts of 1926, 1924, 1921 and 1918.* The repeated reenactment of the provisions of Section 104 of the Revenue Act as they appear in the Revenue Acts of 1918, 1921, 1924, 1926, 1928 and 1932 "is upon accepted principles a Congressional adoption of the regulation as correctly interpreting these sections." *White v. U. S.*, 305 U. S. 281, 291. A clearer case for the application of that principle can scarcely be imagined.

The words of the regulation are tailor-made for the facts as found by the Board in this case. The petitioner's argument is directly contrary to his own regulation which now has the force of law. No reason has been suggested why the regulation should not be given full force and effect in this case as doubtless it has in many others which have come before the Commissioner.

In view of the foregoing the following conclusion of the Court below based in its entirety on facts found by the Board cannot be successfully challenged as a matter of law (4 R 1286-7):—

> "In the present case, petitioner [present respondent] was formed to be the directing head of the whole integrated enterprise, supplanting, in that respect, the Jersey Company, which became a 'mere shell.' Its purpose was to keep the enterprise intact, not to milk it dry and allow it to disintegrate in 1940. The commitments [petitioner] made in 1911 by guaranteeing dividends of 9 per cent on the common stock of the Jersey Company, and the guarantee it made in the 'bypass agreement' of 1914, made it necessary for [peti-

*Revenue Act of 1926—Regulations 69, Article 352
Revenue Act of 1924—Regulations 65, Article 352
Revenue Act of 1921—Regulations 62, Article 352
Revenue Act of 1918—Regulations 45, Article 352
Revised 4-17-1919.

tioner], in protection of its investment, to exercise an active supervision over the underlying operating companies, whose continued success was so vital to its own financial health. Since, under the by-pass agreement, it drew up into its own treasury the earnings of the subsidiary companies without allowing the individual companies to make the accumulations which they normally would have needed for their own corporate purposes, [petitioner], as banker for the enterprise, necessarily had to have a very substantial accumulation of funds at its disposal.

"Considering [petitioner's] activities and commitments, it seems to us to be a good deal more than a 'mere holding company' having 'no need for the accumulation of gains and profits.' Certainly, from the businessman's point of view, [petitioner's] business is the business of the stockyards enterprise as a whole. The enterprise is a close-knit organism composed of many corporate members, of which [petitioner] is the corporate head, supplying the direction and coordination. This appears clearly enough from the facts already stated, and in the Board's findings, not previously quoted: • • •"

The taxpayer was, therefore, fully justified as a matter of good business in accumulating a surplus; and the propriety of its action was recognized both by the Commissioner in his regulations and by the Congress in giving the regulation the force of the statute.

(f) The responsibility resulting from absorbing revenue of subsidiaries.

Furthermore, for taxpayer to have distributed all its earnings would have been *illegal*. It must be remembered, as the Court below points out, that taxpayer "proceeded to build up in its treasury a strong position in cash and liquid

assets with a view to achieving the goal set for 1940. In general, petitioner [respondent here] did not permit the various subsidiary companies to make accumulations which would normally have been appropriate for their individual needs but sucked up into its own treasury most of the available funds in the various companies of the enterprise, and advanced funds to the subsidiaries as the need arose." There can be no doubt about it. The Board found in a supplementary finding of fact (3R. 1202):

> "47. During the years 1922-1933, inclusive, the petitioner [respondent here] withdrew from the Jersey Company and its subsidiaries in dividends more than the net earnings of the Jersey Company and its subsidiaries for that period available for distribution to the petitioner [respondent here]."

Under such circumstances this taxpayer could justly have been condemned both economically and legally (as many holding companies have been) if it had absorbed the earnings of subsidiaries and distributed them without regard for the welfare of the operating units. It not only did not do so; it had contracted with the Jersey Company that it would not permit any exhaustion of the Jersey treasury to defeat the obligations of the Jersey Company. The provision in question is as follows (Ex S-46 pages 52-53 infra):

> "All income of the New Jersey Company hereafter received or collected by it from any source whatever, shall be by it applied first to the payment of its own expenses; second, to the payment of all taxes payable or chargeable to the New Jersey Company; and the surplus then, if any, remaining, shall be paid to the Maine Company upon its request, *but subject, however, to any agreements or obligations on the part of the New Jersey Company now existing.*" (Italics supplied.)

From October 1, 1914, to December 31, 1933, the taxpayer received over thirty million dollars under this agreement. To the extent of at least twenty-five million dollars the taxpayer was under the heaviest sort of obligation so to deal with these funds as to assure financial protection to the creditors and stockholders of the Jersey Company. That corporation on October 1, 1914, had funded obligations outstanding amounting to $18,911,000, and there was $6,500,000 of preferred stock also in the hands of the public (Ex S-46). Moreover (as above indicated) the Jersey Company was itself a holding company owing duties of good faith to its subsidiaries in additon to the discharge of its purely legal commitments.

It is not merely an economic but a legal duty of a holding company under such an arrangement as the taxpayer had made with the Jersey Company so to deal with its receipts as to give the creditors and stockholders of the Jersey Company ample protection to the full amount of their claims. The books are full of cases of holding companies which have been determined to be liable for failure to provide such protection. See *Taylor v. Standard Gas & Electric Company*, 306 U. S. 307, 323-324; *Vallery v. Denver & Rio Grande Railroad Company*, 236 Fed. 176. If the taxpayer had adopted the policy which the Board made mandatory, it would have distributed all of its earnings to Mr. Prince. Had it done so both the corporation and he would have been compelled to answer both to the preferred stockholders of the Jersey Company, as in the *Taylor* case, and to the creditors of the Jersey Company, as in the *Vallery* case. It was therefore legally incumbent upon the taxpayer to act as it always had acted and to accumulate sufficient money to provide for the protection which it always planned to provide.

What has just been said would be true at any time. It was particularly true in 1930-1933 in the depths of the worst depression this country has ever seen.

(2) The Court Below Did Not "Substitute Its Judgment for That of the Board."

The petitioner contends that the Board, without the aid of statutory presumption, made findings of fact from which it inferred the existence of the interdicted purpose and that the Court below overturned this factual inference and substituted its own judgment for that of the Board.

This is a pivotal contention; for if it were sound the taxpayer would have to concede that the Court below erred. But it is demonstrably unsound—and this for three reasons.

In the first place, this is *not* a case in which the Circuit Court of Appeals (as in the *National Grocery* case) decided a question of fact differently from the Board. The Court merely remanded the instant case to the Board for its reconsideration and was scupulously careful to avoid the very error which the petitioner mistakenly imputes to it. That this is a correct statement clearly appears from the opinion of Judge Magruder, and particularly from the following passage (4 R 1297):

> "* * * the Board will have before it the ultimate question whether petitioner has sustained the burden of proving that the Commissioner's determination was wrong, that is, whether the Board is satisfied on a preponderance of the evidence that in Prince's decision on behalf of petitioner to distribute no more than $400,000 in dividends in each of the taxable years, the forbidden motive of surtax avoidance played no substantial part."

In the second place, the action taken by the Court on this phase of the case was merely a familiar exercise of a court's discretion to order a new trial when the court believes that the jury's approach to the vital issue has been disturbed by extraneous considerations. When under such circumstances a verdict is set aside and a new venire ordered, nobody supposes that the court is substituting its judgment for that of the jury. Everybody understands that the jury will have the last "say" on the question of fact and that reconsideration is ordered merely to insure a fair trial. In the instant case the Circuit Court of Appeals rightly concluded that the question whether the taxpayer was a mere holding company had so engrossed the attention of the Board as to give the taxpayer less than a fair chance to have the really vital issue in the case independently considered and decided by the Board itself. We submit that a reading of the opinion of the Board should satisfy this Court that the Court below exercised a sound discretion in an effort to avert a possible injustice.

Finally (and in confirmation of the point last urged) the Court's attention is called to the fact that the Board made no specific finding of the facts from which it drew the vital inference of illicit purpose: it merely resorted, in the course of its opinion, to the familiar device of buttressing a decision already reached on other grounds by observing that the case would be decided in the same way if the main basis of the decision were erroneous.

That this is a correct interpretation of the Board's action will appear if first the applicable paragraph of the Board's opinion is read and, second, if the facts therein summarized are considered one by one. The paragraph in question is as follows (3 R 945):

"Even without the benefit of the statutory presumptions, we think there is sufficient evidence in the record to show the existence of the condemned purpose. The bare recital of the undisputed facts relating to the organization of the petitioner, the balance sheets, the source of earnings, the nature of the investments, the large accumulations of cash and surplus, the loans of cash and securities to the petitioner's sole stockholder, and the continued reinvestment of its gains and profits in securities, present, in our opinion, a situation typical of situations which Congress intended to cover by section 104 of the Revenue Acts of 1928 and 1932."

What the Board itself thus describes as a "bare recital" covers seven matters of fact which, whether considered singly or all together, cannot possibly supply a legitimate premise for the asserted conclusion.

The first fact said to support the inference of an intent to evade income tax liability is "the undisputed facts relating to the organization of the respondent." The undisputed facts are that the respondent taxpayer was organized in 1911, two years before the Sixteenth Amendment was adopted, that it was formed to take the position in the Stock Yards enterprise theretofore occupied by the Jersey Company, that its immediate purpose was to establish a community of interest between the stock-yards industry and the packers, and that its organizers (Prince and Armour) planned from the outset to accumulate earnings for the ultimate liquidation of the Jersey Company without dismembering the integrated enterprise. From these indisputable facts an inference of honest purpose may fairly be drawn—but nothing else. Indeed the petitioner never contended to the contrary; and the Board has itself expressly held that the interdicted purpose cannot be in-

ferred from the organization of taxpayer for the Board says in its opinion (3 R 934):

> "The petitioner was formed in 1911. It clearly was not formed for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its gains or profits to accumulate instead of being divided or distributed, and the respondent does not so contend."

The second basis of inference is "the balance sheets." But the balance sheets show only the fact of accumulation: they throw no light whatever on the reasonableness of it. It is precisely because the mere existence of an accumulation may have led the Board to its ultimate conclusion, that the Court below remanded the case for further consideration by it as the ultimate trier of fact.

The third basis is "the source of earnings." The implication is that the taxpayer merely holds the shares of other corporations and receives such dividends as they are pleased to declare. In other words, the Board is here again conceiving of the taxpayer as a mere holding or investment company—while professing not to do so. The fact is that the taxpayer's "sources of income" have always been the earnings of the Stock Yards enterprise as a whole, which the taxpayer has gathered into its treasury through dividends declared at taxpayer's direction. The earnings, when thus assembled, have been accumulated to retire bonds and stock held by the public and, in the interval, to service the financial needs of the several subsidiaries. These "sources of income", when the facts are known, cannot possibly be a basis for inferring a purpose to evade taxes. The income of taxpayer from sources other than the Stock Yards enterprise was only slightly in excess of one per cent.

The fourth basis is "the nature of the investments." Quite obviously the nature of the investments is irrelevant to the issue. The bare *existence* of investments (into which earnings have been put) would be significant—but only if taxpayer were a mere holding company. It is, however, a significant fact that over 94% of respondent's investments were in the securities of members of the integrated enterprise (3 R 919). The contrast with such a case as the *National Grocery* case could not be more striking.

The fifth basis is "the large accumulations of cash and surplus." Here again we get a glimpse into the mind of the Board: what really motivated the decision was the mere existence of large accumulations, without regard to their justification or propriety. Clearly the mere existence of accumulations is without significance unless the corporation is a mere holding or investment company. Nothing could be more persuasive of the rightness of Judge Magruder's analysis of the Board's decision when he says that the Board's ultimate finding of the forbidden purpose was predicated chiefly upon its finding that taxpayer was a mere holding or investment company which had accumulated profits beyond its reasonable needs (4 R 1296). This alone is a most compelling reason for the new trial which has been granted by Court below.

The sixth basis is "the loans of cash and securities to the petitioner's [respondent's] sole stockholder." The bare fact that such loans were made can support no inference whatsoever. The actual fact that practically all of them were made to accomplish the purpose for which the taxpayer was formed is wholly consistent with an honest purpose and supports no inference to the contrary. Upon this point we submit that the following from the opinion of Judge Magruder is the only sound analysis (4 R 1295-6):

"• • • during the period 1930-1933 Prince's net debt to petitioner increased by $886,070, which increase was more than accounted for by the loan of $1,000,000 to Prince in 1933 to enable him to purchase a large block of stock in Armour & Company. This purchase, as indicated by the Board's finding which we have previously quoted, redounded to the benefit of petitioner. The significance of the loans to Prince is tied up with the question whether petitioner has accumulated profits beyond the reasonable needs of the business. If, on a proper view, such accumulations were deemed to be not unreasonable, this would suggest a possible reason why loans were made to Prince instead of increased dividends. The loans bore interest and were amply secured by a deposit of collateral, and hence did not impair petitioner's plan of accumulation. Of course, if there were no need of any further accumulation in 1933, the loan of $1,000,000 to Prince in that year to enable him to buy his way into Armour & Company, instead of paying a dividend to him in that amount, would take on added significance."

The seventh (and final) basis of inference is "the continued reinvestment of its gains and profits in securities." This is a mere reassertion of the proposition (which at this point the Board is professing to ignore) that the taxpayer is a company bound not to accumulate or to invest its earnings but merely to distribute them. We respectfully submit that this constant reiteration by the Board of this single proposition demonstrates the need of a new trial if, as we contend, the Court below was right in deciding that the taxpayer is *not* a mere holding or investment company within the meaning of the Act of Congress; and is the head of one integrated enterprise.

It thus appears that the so-called "finding" on which the Commissioner so strongly relies is nothing but a

begging of the question adroitly made to appear like a process of reasoning. In no instance, in the so-called finding or elsewhere in the record, did the Board make a finding of a single evidential fact that the condemned purpose actually existed during any of the years in issue.[1] On the contrary, when faced squarely with the question as to whether the condemned purpose actually existed, the member of the Board who wrote the majority opinion, answered in the negative. His language, with italics supplied by us, follows:

> "I might state at this point that I never had any doubt from the testimony in this case, that Mr. Prince and the others in authority here *had an expectation* all during the years 1920 to 1933 inclusive, *to liquidate the Jersey Company.* I think that the testimony warrants that, but was not the basis of any conclusion that I reached. If any member of the Board reached a contrary conclusion from any statement made in the opinion, why it should be corrected, of course." (3 R 1072.) (Italics supplied.)

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[1] In a footnote to page 18 of petitioner's brief there is a reference to transactions in 1931-1933 and in 1918 between Prince and respondent. The reference to the 1918 transaction is misleading unless supplemented by the explanation appearing in Volume 3 of the Record at pages 1019-1021, from which it appears that Prince's personal taxes were substantially increased by the transaction—a fact which caused one of the members of the Board to refer to this transaction as a "dead cat" (3 R 1082). As to the later transactions, as pointed out by member Sternhagen in his dissenting opinion, aside from the fact that the amounts were comparatively too small to be indicative of purpose under Section 104, such transactions in themselves have no significance in determining whether the corporation was availed of to prevent a surtax on the shareholders through the means of allowing its gains or profits to accumulate instead of being divided or distributed.

And again he said (3 R 1073):

> "I could not find from the record any evidence that the Maine Corporation had any purpose except the purpose of Prince, and the company could not have, the corporation can't have a purpose except the purpose of its officers or directors, and *I have no doubt that Prince had the idea, I think it was plain all through this testimony, that it was his idea to accumulate money in the Maine Company for the purpose of purchasing common and preferred shares to pay off not only all of the bonds of the Jersey Company in or before 1940 but all of the indebtedness of all of the other corporations.*" (Italics supplied.)

And again he said (3 R 1078):

> "Was that the purpose of bringing in this so-called newly discovered evidence, to prove what I stated that I am sure the evidence does support, that is, *I think evidence in the record supports the proposition that Prince and his associates,* if he had any, Armour, or away back before Armour got out of the Maine Company but they *had it in their minds to use this company to accumulate funds whereby they could acquire the stock of Jersey Company, and also acquire enough money to pay off all of the indebtedness of not only the Maine Company but the Jersey Company and all of the other companies on up to 1940?*"
>
> • • • • • •
>
> "What I call the liquidation of the Jersey Company, it is more than that, it is the acquisition of the shares of stock of another corporation, and now it seems to me that any holding company can do that but it does not seem to me that that is within the reasonable needs of the business within the meaning of the statute, and I so stated in the opinion." (Italics supplied.)

Conclusion.

The Circuit Court of Appeals asserted no right to draw a factual inference different from that of the Board. The Circuit Court of Appeals without expressing its own view on the ultimate question of fact merely remanded the case to the Board for its decision, instructing the Board that it was mistaken as a matter of law in interpreting the words "mere holding or investment company" as used in the Act as applicable to a company like the taxpayer, and instructing it to decide the factual issues in the light of this instruction.

We urge upon this Court a consideration of the injustice which would result, if the taxpayer were never to have a chance to present its case to the Board without being met at every turn by a persistently mistaken notion of its true nature and function.

Respectfully submitted,

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Appendix.

EXHIBIT S-46.

THE CHICAGO JUNCTION RAILWAYS

AND

UNION STOCK YARDS COMPANY

AND THE

CHICAGO STOCK YARDS COMPANY

AGREEMENT

Relating to Application of Income
Dated 1st October 1914

An Agreement made this first day of October 1914 between THE CHICAGO JUNCTION RAILWAYS AND UNION STOCK YARDS COMPANY incorporated under the laws of New Jersey (hereinafter called the *New Jersey Company*) of the one part the CHICAGO STOCK YARDS COMPANY incorporated under the laws of Maine (hereinafter called the *Maine Company*) of the other part

WHEREAS the *Union Stock Yards & Transsit Company* (hereinafter called the *Transit Company*) is a corporation duly organized under the laws of Illinois and has issued and outstanding 132,000 common shares of the par value of $100 each and $500,000 4½ per cent gold debentures dated 1st January 1910 payable 1st January 1920 issued under an indenture between the *Transit Company* and the

First Trust & Savings Bank dated 1st January 1910

Common Shares	$13,200,000
Debentures	500,000
Total Capitalization of the *Transit Company*	$13,700,000

AND WHEREAS the *Chicago Junction Railway Company* (hereinafter called the *Railway Company*) is a corporation duly organized under the laws of Illinois and has now issued and outstanding 55,000 common shares of the par value of $100 each

Common Shares	$5,500,000
Total Capitalization of the *Railway Company*	$5,500,000

AND WHEREAS the railways of the *Transit Company* are leased to the *Railway Company* by instrument dated 1st December 1913 under which the *Railway Company* is bound to pay as annual rent the sum of $600,000 to the *Transit Company* or upon its order

AND WHEREAS the *New Jersey Company* now has issued and outstanding

(*a*) 130,000 shares of capital stock of the par value of $100 each of which 65,000 are 6 per cent cumulative preferred shares and 65,000 are common shares

Preferred Shares	$6,500,000
Common Shares	6,500,000

(*b*) $10,000,000 Five Per Cent Collateral Trust Gold Bonds dated 1st July

1890 payable 1st July 1915 issued under a deed of trust from the *New Jersey Company* to the *Central Trust Company of New York* dated 10th July 1890 whereby 120,000 shares of the *Transit Company* are pledged as security for the said bonds

5% Bonds	$10,000,000

(*c*) $4,000,000 Four Per Cent Forty Year Mortgage and Collateral Trust Refunding Gold Bonds dated 1st April 1900 payable 1st April 1940 issued under a mortgage and deed of trust from the *New Jersey Company* to *The Standard Trust Company of New York* dated 10th April 1900 whereby there are pledged as security for the said bonds 11,083 shares of the *Transit Company* 54,991 shares of the *Railway Company* and $2,500,000 Fifty Year General Mortgage Gold Bonds of 1907 of the *Indiana Harbor Belt Railroad Company* dated 1st July 1907 payable 1st July 1957 issued under a mortgage from the *Indiana Harbor Belt Railroad Company* to the *Guaranty Trust Company of New York* dated 1st November 1907 and the said 120,000 shares of the *Transit Company* (subject to the lien of the said Five Per Cent Collateral Trust Gold Bonds)

4% Bonds	4,000,000
Total Capitalization of the *New Jersey Company*	$27,000,000

AND WHEREAS the *New Jersey Company* has guaranteed the payment of the principal interest and sinking fund of a total authorized issue of $3,000,000 First Mortgage Five Per Cent Twenty Year Real Estate Improvement Bonds dated 1st March 1908 payable 1st March 1928 issued under a mortgage and deed of trust from *John A. Spoor Frederick S. Winston* and the *New Jersey Company* to the *Standard Trust Company of New York* dated 1st March 1908 of which there are now outstanding $2,584,000 bonds

Real Estate Bonds	$3,000,000

AND WHEREAS the *New Jersey Company* has guaranteed the payment of the principal and interest upon $2,327,000 first mortgage Four Per Cent Forty Year Gold Bonds of *The Chicago Junction Railroad Company* dated 1st March 1905 payable 1st March 1945 issued under a first mortgage from *The Chicago Junction Railroad Company* to the *First Trust and Savings Bank of Chicago* dated 1st March 1905

Railroad Bonds	$2,327,000

AND WHEREAS the *New Jersey Company* owns or controls all of the shares in the capital stock of the *Transit Company* and of the *Railway Company* now issued and outstanding

AND WHEREAS the *Maine Company* now owns 31,075 common shares of the *New Jersey Company* and certifi-

cates representing 33,922 common shares of the *New Jersey Company* have been deposited with the *Old Colony Trust Company* under an agreement between said *Old Colony Trust Company* and the *Maine Company* dated 27th September 1911 and the *Maine Company* has in accordance with the said agreement endorsed the said certificates as follows:

"The *Chicago Stock Yards Company* does hereby guarantee to the holder of the shares evidenced by this certificate and the assigns of such holder and to the transferee hereof, to pay to the registered holder of said shares at the time of such payment, on the first days of January, April, July and October in each and every year, beginning on the 1st day of January 1912 a fixed sum amounting to two and one-fourth per cent. upon the par value of said shares, in consideration of which guaranty and the due and punctual performance thereof from time to time, the holder of said shares and each and every assign thereof does hereby sell, assign, set over and direct to be paid to the *Old Colony Trust Company*, as Trustee under the agreement hereinafter mentioned, or upon its written order, any and all dividends and other payments out of earnings apportionable to the shares represented by this certificate or directed to be paid to the holder hereof, which may at any time be made by or on behalf of *The Chicago Junction Railways and Union Stock Yards Company*, or its successor, to be by said Trustee disposed of as in said agreement specified and provided.

This indorsement is placed hereon pursuant to and subject to the terms and conditions of a certain Trust Agreement dated 27th September 1911, signed

by the *Chicago Stock Yards Company* and deposited with the *Old Colony Trust Company*, as Trustee, to which the holder hereof has assented and become a party.

Each and every assign or transferee of this certificate, by accepting delivery hereof, does accept and confirm the above-mentioned assent of the holder and the terms and conditions of said Trust Agreement and become a party thereto and does direct the placing of this indorsement on any new certificate which may be issued in lieu hereof.

CHICAGO STOCK YARDS COMPANY

By

Assistant Secretary."

so that the *Maine Company* is now entitled to all of the income of the *New Jersey Company* applicable to dividends on the common shares of the *New Jersey Company*

And Whereas the parties hereto desire to simplify their financial relations and operations for their mutual benefit and the protection of the various creditors holders of securities and shareholders respectively

Now therefore in consideration of the premises and of the mutual promises herein contained it is agreed by and between the parties hereto as follows

1. The *Maine Company* hereby guarantees to the *New Jersey Company* the prompt payment of the following

(*a*) All expenses interest and taxes payable by or chargeable to the *New Jersey Company* including certain principal and interest payments under the two contracts between *Richard Fitzgerald* the *Merchants'*

Loan & Trust Company and *Anna L. Sexton* both dated 1st June 1914 and the interest on certain demand notes of the *New Jersey Company* aggregating $259,520 secured by 548 shares of the *Transit Company*

(*b*) The interest upon the said Five Per Cent Collateral Trust Gold Bonds and the said Four Per Cent Forty Year Mortgage and Collateral Trust and Refunding Gold Bonds when and as the same becomes due and payable and the *Maine Company* further agrees to make the payments and to fulfil all of the obligations of the *New Jersey Company* under the mortgages and deeds of trust securing the said bonds except the payment of the principal of the said bonds

(*c*) All payments which the *New Jersey Company* may be required to make under and in accordance with Article 6 section 3 of the said mortgage and deed of trust from *John A. Spoor Frederick S. Winston* and the *New Jersey Company* to the *Standard Trust Company of New York* dated 1st March 1908 and all other payments other than the principal of the said First Mortgage Five Per Cent Twenty Year Real Estate Improvement Bonds which the *New Jersey Company* may be required to make under and in accordance with the covenants contained in the said mortgage to be performed by the *New Jersey Company*

(*d*) All payments which the *New Jersey Company* may be required to make by virtue of its guaranty of the interest but not of the principal of the said $2,327,000 First Mortgage Four Per Cent Forty Year Gold Bonds of *The Chicago Junction Railroad Company*

(*e*) Dividends at the rate of 6 per cent per annum upon the preferred shares of the *New Jersey Company* now issued and outstanding

(*f*) Fixed sums on the first days of January April July and October in each year amounting to 2¼ per cent upon the par value of all common shares of the *New Jersey Company* now or hereafter deposited with the *Old Colony Trust Company* as trustee under the said agreement dated the 27th September 1911

2. The *New Jersey Company* assigns and transfers to the *Maine Company* all its right title and interest in and to any dividends that may hereafter be declared by the *Transit Company* and the *Railway Company* respectively and all its right title and interest in and to all income and surplus earnings of the said companies or either of them that may now or hereafter be divisible or distributable among the shareholders of the said companies or either of them in the form of dividends or otherwise subject however to all obligations and agreements respecting such dividends and income as may now exist

3. The *New Jersey Company* as the owner of all of the shares in the capital stock of the *Railway Company* and in fulfillment of its obligations under the preceding paragraph hereof and for the purpose of insuring the performance by the *Maine Company* of its agreements hereunder hereby agrees to direct the *Railway Company* from time to time out of the funds in its treasury otherwise applicable to the payment of dividends on the shares of its stock owned by the *New Jersey Company* to pay the following

(*a*) On or before the 1st days of June and December in each year the *Railway Company* shall be

directed to pay to the *Central Trust Company* of New York the sum of $250,000 to be applied to the payment of interest on the said Five Per Cent Collateral Trust Gold Bonds of the *New Jersey Company* PROVIDED that after the said bonds shall have been paid or retired the said sums shall be paid in accordance with the order of the *Maine Company*

(*b*) On or before the 15th days of March and September in each year the *Railway Company* shall be directed to pay to the *Guaranty Trust Company of New York* the sum of $80,000 to be applied to the payment of interest on the said Four Per Cent Forty Year Mortgage and Collateral Trust Refunding Gold Bonds of the *New Jersey Company* PROVIDED that after the said bonds shall have been paid or retired the said sums shall be paid in accordance with the order of the *Maine Company*

(*c*) Whenever it shall from time to time appear that the *Railway Company* will have in its treasury funds sufficient to make the payments above specified as the same become due it may pay any surplus of the said funds to the *Maine Company* upon its request

4. The *New Jersey Company* as owner of all of the shares in the capital stock of the *Transit Company* and in further fulfillment of its obligations under paragraph 2 hereof and for the purpose of insuring the performance by the *Maine Company* of its obligations hereunder hereby directs the *Transit Company* from time to time out of the funds in its treasury otherwise applicable to the payment of dividends on the shares of its stock owned by the *New Jersey Company* to pay the following

(*a*) On or before the 25th days of March June September and December in each year the *Transit Company* shall be directed to pay to the *Old Colony Trust Company* the sum of $97,500 to be by it applied to the payment of the quarterly dividends on the preferred shares of the *New Jersey Company* now issued and outstanding

(*b*) On or before the 25th days of March June September and December in each year the *Transit Company* shall be directed to pay to the said *Old Colony Trust Company* the sum of $76,324.50 to be by it applied to the payment on the 1st days of January April July and October of the sums payable under the said agreement of the 27th September 1911 to holders of common shares of the *New Jersey Company* deposited thereunder or such other sums as may from time to time be sufficient and payable for that purpose

(*c*) Whenever it shall from time to time appear that the *Transit Company* will have in its treasury funds sufficient to make the payments above specified as the same become due it may pay any surplus of the said funds to the *Maine Company* upon its request

5. The *New Jersey Company* agrees that it will by irrevocable instrument order the *Transit Company* to authorize and direct the *Railway Company* to apply the annual rent of $600,000 payable under the said lease to the payments to be made by the *Railway Company* under the provisions of paragraph 3 hereof

6. All income of the *New Jersey Company* hereafter received or collected by it from any source whatever shall be by it applied *first* to the payment of its own expenses

second to the payment of all taxes payable or chargeable to the *New Jersey Company* and the surplus if any then remaining shall be paid to the *Maine Company* upon its request but subject however to any agreements or obligations on the part of the *New Jersey Company* now existing. Whenever practicable the *New Jersey Company* shall authorize the *Maine Company* to collect such other income direct from the source thereof and shall take all such proceedings and do all such acts as may be necessary or expedient to enable the *Maine Company* so to do

7. The *New Jersey Company* may from time to time with the written consent of the *Maine Company* issue additional bonds or debentures secured by mortgage or otherwise or may guarantee the payment of principal and interest of bonds and debentures of other companies associations organizations or individuals whether or not the same are secured by mortgage whenever such issue or guaranty appears to be for the best interest of the *New Jersey Company* And in the event that bonds or debentures are so issued or guaranteed the *Maine Company* guarantees to the *New Jersey Company* the prompt payment of all interest sinking fund payments expenses and taxes which the *New Jersey Company* may be required or obliged to make in respect of such bonds or guaranty

8. Both parties hereby agree to execute and deliver all agreements and instruments that may be necessary or proper to enable the provisions of this agreement to be carried out and fulfilled according to the true spirit hereof, it being understood however that nothing herein contained shall be construed to require any corporation or person to do anything contrary to its existing contracts or obligations

9. The president or treasurer of the *Maine Company* and of the *New Jersey Company* respectively may from time to time determine all questions which may arise relating to the accounts between the said companies and may make such payments from one company to the other as may be necessary or convenient in order to carry out the true intent and purpose of this agreement

10. This agreement may be amended modified or rescinded at any time by action of the boards of directors or executive committees of the parties

IN WITNESS WHEREOF the parties have caused their respective common seals to be hereto affixed and these presents to be signed in their respective names and on their behalf by their respective officers thereunto duly authorized the day and year first above written Executed in four parts

THE CHICAGO JUNCTION RAILWAYS AND UNION STOCK YARDS COMPANY

By

FREDERICK H. PRINCE
President

Attest

M. A. TAYLOR
Secretary

C. J. Rwys. &
U. S. Y. Co.
SEAL

CHICAGO STOCK YARDS COMPANY

By

NORMAN J. MacGAFFIN
President

Attest

EDWARD N. MANNING
Secretary

C. S. Y. Co.
SEAL

CHICAGO STOCK YARDS ENTERPRISE

December 31, 1933

Chicago Stock Yards Company
(Maine Co.)
Inc Maine Sept 25, 1911
Cap Stock $8,000,000 par value – 80,000 shares
Bonds Outstanding – $2,620,000

Produce Terminal Corporation
Inc Illinois 1915
Cap Stk $2,000,000. –
20,000 shares
Wholly owned by Maine Co.

The Chicago Junction Railways and Union Stock Yards Company
(New Jersey Co.)
Inc New Jersey 1890
Cap Stk Pfd $6,500,000 – 65,000 shares
2,362 shares owned by Maine Co.
Com $6,500,000 – 65,000 shares
60,33⅓ shares owned by Maine Co.
Maine Co. is entitled to all net income of this company in excess of 6% dividends on Pfd. and 9% dividends on Com. not owned by it
Bonds outstanding – $14,000,000
Bonds guaranteed – $2,327,000 of Railroad Co.
$2,250,000 of C.M.D.

Pau Corporation
Inc Ill. 1931
Cap Stk $5,000.
50 shares
Wholly owned by Maine Co.

The Union Stock Yards and Transit Company of Chicago
(Transit Co.)
Inc Illinois 1865
Cap Stk $13,200,000. –
132,000 shares
Wholly owned by New Jersey Co.

The Stock Yards Harness and Saddlery Company
(Harness and Saddlery Co.)
Inc Illinois 1903
Cap Stk $10,000. – 100 shares
Wholly owned by Transit Co.

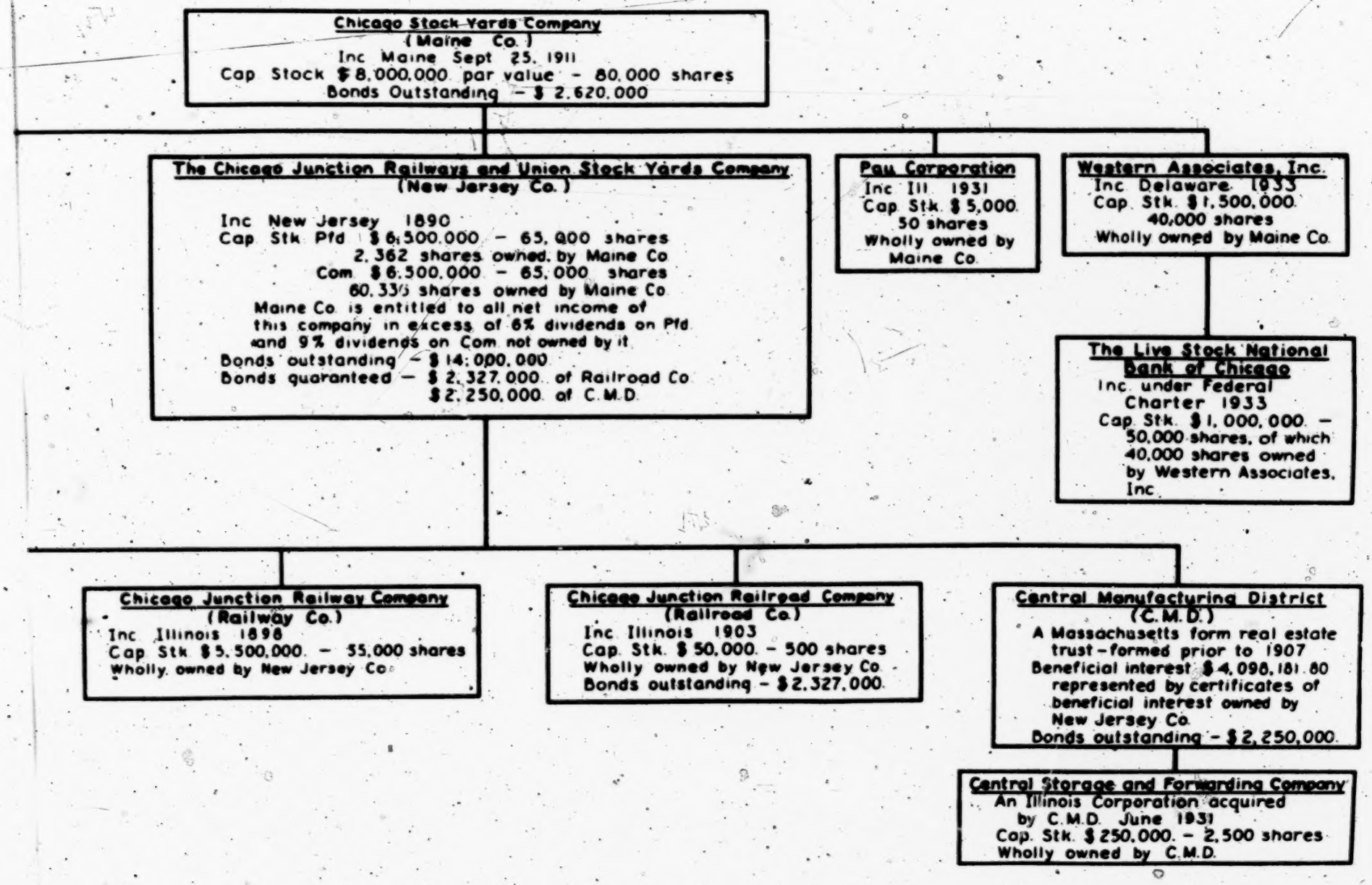
Chicago Junction Railway Company
(Railway Co.)
Inc Illinois 1898
Cap Stk $5,500,000. – 55,000 shares
Wholly owned by New Jersey Co.

Chicago Junction Railroad Company
(Railroad Co.)
Inc Illinois 1903
Cap Stk $50,000. – 500 shares
Wholly owned by New Jersey Co.
Bonds outstanding – $2,327,000.

CHICAGO STOCK YARDS ENTERPRISE

TAXPAYER'S EXHIBIT NO. 1.

December 31, 1933


Chicago Stock Yards Company
(Maine Co.)
Inc Maine Sept 25, 1911
Cap Stock $8,000,000 par value - 80,000 shares
Bonds Outstanding - $2,620,000
The Chicago Junction Railways and Union Stock Yards Company
(New Jersey Co.)
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Cap Stk Pfd $6,500,000 - 65,000 shares
2,362 shares owned by Maine Co
Com $6,500,000 - 65,000 shares
60,33⅓ shares owned by Maine Co
Maine Co is entitled to all net income of this company in excess of 6% dividends on Pfd and 9% dividends on Com not owned by it
Bonds outstanding - $14,000,000
Bonds guaranteed - $2,327,000 of Railroad Co
$2,250,000 of C.M.D.
Pau Corporation
Inc Ill 1931
Cap Stk $5,000
50 shares
Wholly owned by Maine Co
Western Associates, Inc.
Inc Delaware 1933
Cap Stk $1,500,000
40,000 shares
Wholly owned by Maine Co
The Live Stock National Bank of Chicago
Inc under Federal Charter 1933
Cap Stk $1,000,000 - 50,000 shares, of which 40,000 shares owned by Western Associates, Inc
Chicago Junction Railway Company
(Railway Co.)
Inc Illinois 1898
Cap Stk $5,500,000 - 55,000 shares
Wholly owned by New Jersey Co
Chicago Junction Railroad Company
(Railroad Co.)
Inc Illinois 1903
Cap Stk $50,000 - 500 shares
Wholly owned by New Jersey Co
Bonds outstanding - $2,327,000
Central Manufacturing District
(C.M.D.)
A Massachusetts form real estate trust - formed prior to 1907
Beneficial interest $4,098,181.80 represented by certificates of beneficial interest owned by New Jersey Co
Bonds outstanding - $2,250,000
Central Storage and Forwarding Company
An Illinois Corporation acquired by C.M.D. June 1931
Cap Stk $250,000. - 2,500 shares
Wholly owned by C.M.D.

SUPREME COURT OF THE UNITED STATES.

No. 488.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Chicago Stock Yards Co. } On Writ of Certiorari to the Circuit Court of Appeals for the First Circuit.

[April 12, 1943.]

Mr. Justice Roberts delivered the opinion of the Court.

The Board of Tax Appeals sustained the petitioner's determination of deficiencies in the respondent's income tax for 1930, 1932, and 1933.[1] The Circuit Court of Appeals reversed the Board's decision.[2] We granted certiorari because of the importance of the questions involved.

The challenged assessment was of the fifty per cent. additional tax imposed by § 104 of the Revenue Acts of 1928 and 1932.[3] The section, which is substantially the same in both statutes, provides, in subsection (a), that if any corporation is formed or availed of for the purpose of preventing the imposition of surtax upon its shareholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, the additional tax shall be imposed. That the corporation "is a mere holding or investment company," or that the gains or profits are "permitted to accumulate beyond the reasonable needs of the business," is declared, by subsection (b), prima facie evidence of a purpose to avoid the surtax.

The Union Stock Yards & Transit Company of Chicago, hereinafter called Transit Company, was incorporated in 1865 to operate stock yards in Chicago. Its business was profitable. Frederick H. Prince became a stockholder. In 1890 packers, who were the company's principal source of business, threatened to remove their plants from Chicago unless they were given a share in its profits. Due to limitations in its charter, the corporation could

1 41 B. T. A. 590.
2 129 F. 2d 937.
3 45 Stat. 814-15, 47 Stat. 195.

not raise funds necessary to buy off the packers. Mr. Prince and other stockholders met the situation by organizing a holding company under the law of New Jersey, The Chicago Junction Railways & Union Stock Yards Company, hereinafter called the New Jersey Company, which acquired all of the capital stock of the Transit Company. The capital structure at organization was 65,000 shares each of preferred and common, all of $100 par. Collateral trust bonds, secured by Transit Company stock, were issued, of which $14,000,000 were ultimately outstanding. The charter was to expire in 1940. The New Jersey Company came to own all of the stock of the Transit Company, of a railway company, a railroad company, and all beneficial interest in a real estate trust, which themselves, or through subsidiaries, pursued activities collateral to the stock yards' business. By payments in cash and its own bonds it procured from the packers an agreement to maintain the stock yards at their then location for fifteen years.

When this agreement was about to expire the packers presented fresh demands and Mr. Prince was compelled to devise some method of satisfying them. He decided that if he could obtain the cooperation of the largest he need not trouble about the others. To attain this end he organized, in 1911, the respondent, a Maine corporation. He formed a committee which made a proposal to the New Jersey Company's common stockholders that the respondent would purchase their stock by giving them $200 par of its 5% bonds for each share of common stock or, in the alternative, would stamp the stock with the company's agreement to guarantee a 9% dividend upon it; this in consideration that the respondent should be entitled to all of the New Jersey Company's earnings over and above its expenses, interest charges, and the guaranteed dividend on the common. Thus it was intended to draw into the taxpayer's treasury the excess of the New Jersey Company's earnings. Armour & Co. was given 20% of the respondent's stock, Prince retaining 80% of it. In this way Armour was to share in the earnings of the stock yards.

By a decree in a suit under the Sherman Act, Armour was ordered to part with all interest in the stock yards. In consequence Mr. Prince purchased the Armour-held stock for $1,000,000, which sum was loaned to him by the respondent. Thus Prince became the taxpayer's only stockholder and it is conceded that

he retained ownership or voting power which gave him sole control of the company to the close of 1933.[4]

By August 1914 the respondent had acquired, in exchange for its bonds, 31,075 common shares of the New Jersey Company and 33,922 shares had been stamped with its guarantee. In 1919 it acquired the three remaining shares. In the period from 1915 to 1933 it organized two small wholly-owned subsidiaries to transact business connected with the stock yards' enterprise, and also organized, and held four-fifths of the capital stock of, a national bank intended to serve the stock yard district.

The respondent in addition to the New Jersey Company common stock acquired by exchange of its own bonds therefor, bought such stock for cash. By December 31, 1929, it had acquired 58,742 of the 65,000 shares outstanding.

As the charter of the New Jersey Company was to expire in 1940, Mr. Prince, at some date not clearly fixed by the testimony, formed the plan of accumulating cash in the respondent's treasury sufficient to pay the debts of the New Jersey Company and liquidate it by that time. To do this it would be necessary to redeem the outstanding preferred stock at par, pay off the $14,000,000 mortgage and over $6,000,000 of fixed obligations of subsidiaries which had been guaranteed by the New Jersey Company. It would also be necessary to purchase 6,258 shares of New Jersey common not then owned. Thus, as of December 31, 1929, the plan involved the expenditure of about $28,000,000 by 1940. If it could be consummated, the taxpayer would then own the entire stock yards enterprise clear of debt other than its own bonds then outstanding in the amount of $3,227,000 due in 1961. That enterprise, treated as a whole, then had cash and liquid assets amounting of $21,705,185,[5] and fixed and other assets of a book value of $40,000,000. The bulk of the liquid assets had been drawn up into the respondent's treasury by virtue of the agreement with the New Jersey Company's stockholders.

The respondent's assets December 31, 1929, exceeded its liabilities, including its capital stock, by $19,622,355. From that date to the close of 1933 its earnings were $10,243,373, of which

[4] He placed some of the stock in trust, retaining voting control.

[5] Including some $2,000,000 of impounded charges not released to Transit Company until 1932 and a working fund claimed by respondent to require $5,000,000.

$1,600,000 was paid out in dividends, and $8,643,373 was added to earned surplus.[6]

These are the salient facts. They are stated in greater detail by the Board and by the court below.

The Board reached these conclusions: That the respondent was a mere holding or investment company as defined by § 104, and had not overcome the consequent presumption that its surplus had been accumulated for the purpose of avoiding surtax upon the earnings of Mr. Prince, as sole stockholder; that, although it was more than a mere holding or investment company, its profits had been permitted to accumulate beyond the reasonable needs of the business, and the evidence did not overcome the prima facies which § 104(b) attributes to this fact; and that, without the benefit of the presumptions created by § 104(b), the proofs require the conclusion that the respondent had been availed of for the purpose of accumulating profits beyond its needs for the purpose of avoiding surtax upon its stockholder.

The Circuit Court of Appeals held that, viewing the facts most favorably to the Government, the respondent was not a mere holding or investment company within the meaning of the statute; that, in concluding the company had accumulated profits beyond its reasonable needs, the Board had employed a wrong yardstick in that it had failed to give weight to the controlling purpose of the accumulation, namely, the long range plan to liquidate the New Jersey Company and consolidate all the assets, free of debt, in the respondent; and, finally, that, in purporting to reach its final conclusion without reference to the statutory presumptions, it had allowed them to affect its judgment. Accordingly the court reversed and directed the Board to retry the case in conformity to the court's opinion.

The petitioner urges acceptance of the Board's first conclusion that the respondent was a mere holding or investment company. He says that the taxpayer was nothing but a pocketbook for Mr. Prince who, as an individual, managed and controlled the

[6] This item included additional cash on hand of $2,755,931 ($1,800,000 of which was a subordinated deposit in a stock yards bank), loans to subsidiaries and to Mr. Prince, purchases of common and preferred stock of the New Jersey Company and of respondent's own bonds, and other investments, and an investment of $3,573,218 in securities of stock yards banks which needed financial support. Similar subordinations of deposits and bank investments were made by subsidiaries.

entire enterprise and used the taxpayer merely as a repository of surplus earnings which were intended ultimately to be used for his benefit. We find it unnecessary to consider this contention, since we think the Board's decision may be supported apart from any presumption arising under the terms of the Act.

The respondent was not formed for the purpose of avoiding surtax on its stockholders. No such exaction existed in 1911. Until some effort was made by legislation to reach and tax accumulated and undistributed surplus, the taxpayer's dividend policy was immaterial. Accumulation of profits in its treasury was of no tax significance and, so far as appears, it was otherwise a matter of indifference, legally speaking, whether surplus moneys were allowed to remain in the treasury or were paid in dividends.

The series of acts which sought to discourage such accumulations had its origin in 1913 with the imposition of an additional tax on the shareholder rather than on the corporation.[7] The additional tax was laid on the corporation by the Revenue Act of 1921 and this method was retained in subsequent acts to and including that of 1932.[8] As the theory of the revenue acts has been to tax corporate profits to the corporation, and their receipt only when distributed to the stockholders, the purpose of the legislation is to compel the company to distribute any profits not needed for the conduct of its business so that, when so distributed, individual stockholders will become liable not only for normal but for surtax on the dividends received.

A corporate practice adopted for mere convenience or other reasons, and without tax significance when adopted, may have been continued with the additional motive of avoiding surtax on the stockholders. The Board's conclusion may justifiably have been reached in the view that, whatever the motive when the practice of accumulation was adopted, the purpose of avoiding surtax induced, or aided in inducing, the continuance of the practice.

The Board, the court below, and the parties in brief and argument have discussed many facts thought to be relevant to the

[7] Act of Oct. 3, 1913, ch. 16, 38 Stat. 114, 166-167; Revenue Act of 1918, ch. 18, 40 Stat. 1057, 1072.

[8] Revenue Act of 1921, ch. 136, 42 Stat. 227, 247-248; Revenue Act of 1924, ch. 234, 43 Stat. 253, 277; Revenue Act of 1928, ch. 852, 45 Stat. 791, 814-15; Revenue Act of 1932, ch. 209, 47 Stat. 169, 195. In later revenue acts a different method of accomplishing the purpose has been adopted.

purpose of the accumulation of surplus by the respondent. The interrelation of the taxpayer and the other corporations involved in the enterprise, the expiration of the New Jersey Company's charter, the policy or obligation of the taxpayer to provide for the payment of the debts of the New Jersey Company and its subsidiaries, the relation of Mr. Prince as officer and active manager of underlying corporations, the financial transactions between him and the respondent, are discussed and arguments pro and con are based thereon in an effort to prove or to disprove the character of the respondent, the necessities of its business, and the nature of the relationship between it and Mr. Prince.

If we eliminate these matters from consideration and treat the respondent as a controller, manager, and, to a large extent, the proprietor of the entire enterprise, we think the Board's conclusion of fact has support in the evidence and must be accepted.

The respondent launched its corporate activities with partners and co-investors in the stock yards enterprise. The New Jersey Company, which then embraced the entire business, had a capital investment represented by stock and bonds of not less than $27,000,000. In 1911, when the respondent was organized, the enterprise had a net worth of at least $16,000,000.[9] The respondent, with a paid-in cash capital of $1,000,000, purchased[10] the right to receive the net earnings of the enterprise after the payment of the New Jersey Company's fixed charges, operating expenses, and the guaranteed dividends on its stock. The respondent's goal was the acquisition, by the year 1940, of the interest of all others having any capital share in the enterprise, and the method pursued was to accumulate current earnings[11] so that, by 1940, they would be available for such capital investment. This investment would, of course, redound to the benefit of the holder or holders of the respondent's stock. The situation

[9] The net worth was probably some $3,000,000 in excess of the amount named if the actual net worth of subsidiaries is taken into account.

[10] When the plan and agreement with respect to New Jersey Company's common stock was in shape to be consummated, the respondent purchased the plan and the rights arising under it for $1,000,000 (its cash capital), and $7,000,000 par value of its own stock arising out of an increase of its authorized stock from $1,000,000 to $8,000,000.

[11] The respondent has paid substantial annual dividends, the highest being at the rate of $400,000 per year during the taxable years in question; and Mr. Prince has also received substantial salaries from the respondent and other corporations which were conducting activities of the enterprise.

disclosed is, in legal effect, similar to that presented in *Helvering* v. *National Grocery Co.*, 304 U. S. 282. There the surplus earnings were invested in securities unrelated to the business in hand and were, and would remain, available for whatever purposes Kohl, the sole stockholder, determined. Here the accumulated earnings became available to the investment purpose and program of Mr. Prince, the sole stockholder of the taxpayer, or for other purposes as he might determine. By the use of the taxpayer's corporate personality Mr. Prince could plow the earnings of the enterprise into a capital investment which would convert, by 1940, an original capital venture of $1,000,000 into free assets of a value in excess of $60,000,000. And this without the payment of taxes[12] or surtaxes on the bulk of the earnings. Although Mr. Prince denied any purpose to avoid surtaxes, the Board, as in the *National Grocery* case, was free to conclude, upon all the evidence, that such was the purpose.

The respondent's position is that, as the New Jersey Company's charter was to expire in 1940, and as respondent was under what it deemed a moral, and, indeed, a legal obligation to pay off the mortgage debts of the New Jersey Company and its subsidiaries and to redeem its outstanding stock, the accumulation of earnings was necessary to the preservation of its business. There are two sufficient answers. Mr. Prince, the sole stockholder, if in receipt of the respondent's earnings, could equally well have done what the respondent proposed to do, that is turn accumulated earnings into invested capital. And the evidence shows that the New Jersey Company's charter could have been renewed in 1940. Continuance or refinancing of such an enterprise on the face of things would have been practicable.

We cannot say that the Board's conclusion that respondent was availed of for the purpose of preventing the imposition of surtax upon its stockholders, through the medium of accumulation of its profits, is without substantial support.

The judgment is reversed.

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[12] Most of respondent's income consisted of dividends received from domestic corporations which were deductible from its gross income for tax purposes.